

CORPORATE GOVERNANCE IN THE EUROPEAN COMMUNITY: A (PROPOSAL FOR A) RE-READING OF THE KEY DEFINING ELEMENTS IN THE LIGHT OF EC LAW, AND THE SCOPE FOR A SLIGHTLY “REFINED” DEFINITION

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Introduction

Over the last few years, the awareness of the importance of corporate governance has become manifest at EC level. In addition to its support for “corporate social responsibility” (CSR) in “soft-law” pieces [COM(2002)347final, “A business contribution to Sustainable Development”; COM(2006)136final, “Implementing the partnership for growth and jobs: making Europe a pole of excellence on corporate social responsibility”], the EC addressed an “action plan” to corporate governance laying down its proposed initiatives in 2003, when, in response to the corporate collapses in the USA and to the Serbaney-Oxley Act, the Commission issued its Action Plan on Company Law and Corporate Governance [APCLCG, Commission Communication 284(2003)]. An important part of the APCLCG has been implemented, over the last three years, through “soft-law pieces” and the creation of bodies for information and advice. Specifically, in 2004 the Commission set up the European Corporate Governance Forum [Commission decision of 15 October 2004, 2004/706/EC] as a body for exchange of information and best practices existing in Member States, as well as for reflection and debate, and it issued a Recommendation on an appropriate regime for the remuneration of directors of listed companies [Commission Recommendation of 14 December 2004, 2004/913/EC, fostering an appropriate regime for the remuneration of directors of listed companies]. In 2005, the “follow-up” with this approach included the creation of a group of non governmental experts on corporate governance and company law [Commission decision of 28 April 2005, 2005/380/EC], with the task of providing technical advice to the Commission, and the issue of another soft-law piece, the Recommendation on the role of non-executive or supervisory directors of listed companies and on the committee of the (supervisory) board [Commission Recommendation on the role of non-executive or supervisory directors of listed companies and on the committees of the (supervisory) board of 15 February 2005, 2005/162/EC].

This approach (the search for debate and advice, the frequent resort to “soft-law” in dealing with issues where hard law harmonisation would risk being difficult) appears to be understandable if considering the difficult history of the company law harmonisation program, and, together with this history, seems to explain the orientation of the current debates on corporate governance at the EC level. Notably, the company law harmonisation program undertaken by the EC since the end of the 60s has known, from the 70s onwards, some difficult times: the presence within the Community of Member States embracing the different visions of company law and of corporate governance – the “shareholders primacy” on the one hand, the “stakeholder model” on the other hand – has often caused the harmonisation program to hit up against this contraposition, and has resulted in directives reflecting compromises and having, as the literature has highlighted, limited effectiveness in achieving harmonisation (C.Villiers, 1996, 1998). Such a contraposition has also long been preventing the harmonisation of national laws concerning directors’ duties (the failure of the draft Fifth Directive: J.J.Du Plessis and J.Dine, 1997). In this context, it appears

not surprisingly that the APCLCG has been relying on new Directives (subsequently referred to in the text) only for a part of the initiatives envisaged, and that important debates which are currently going on regarding corporate governance tend to focus on what has been achieved so far, on where the EC stands, on the corporate governance codes that has been developed in individual Member States, on the Commission's policies in the field and on what is still to be expected in terms of new EC initiatives [European Institute of Public Administration (EIPA), Seminar: Corporate Governance from an EU Standpoint, Maastricht, 14-15 December 2006, Introduction to the seminar presentation].

Nevertheless, because all secondary legislation *already* introduced needs to be read in the light of the Treaty, a different question also appears to be of paramount importance: *does the Treaty*, and in consequence the interpretation of the secondary legislation in the light of it, together with the European Court of Justice (ECJ) case-law, *presupposes a particular vision about the corporate objective and, in general, about corporate governance* ? In other words, can the Treaty and EC hard business law already introduced, given the Treaty's objectives, be read in such a way as to "extrapolate" this conception ? In terms of input to debates, this question would pave the way to a shift in the emphasis, from the typical "what the EC *has achieved* and what *could do* in the light of differences in national corporate governance models" to "what the EC *needs to commit itself to doing*, and, in particular, *how the different national corporate governance models need to be assessed*, in the light of a conception already implied in the Treaty and in the *acquis communautaire*".

This question, which appears to have been neglected by the academic literature, owes its importance to the fact that, due to the supremacy of the Community legal order over national laws of Member States, if a particular conception on corporate governance could be seen as underlying the Treaty and, in the light of the Treaty, the "hard law" to date issued, this vision would need to be a "parameter" for corporate governance debates in each individual Member States, to a far greater extent than the "soft-law" pieces – such as the APCLCG, or the Commissions' Communication on CSR issued over the last few years, or the Commission Recommendation – can do on their own. Moreover, as the 50th anniversary of the Treaty falls within a time when, in the aftermath of the corporate collapses in both the USA and in Europe in recent years (2001-2004), corporate governance has been brought at the top of the reform agenda all over the world, the "historical" period would seem to be particularly appropriate for dealing with the issue.

This article wishes to draw a response to this question, by proposing a re-reading, based on the Treaty and on other EC "hard" law, of the key elements of the definition of corporate governance, and is structured in three Sections. Section A, by moving from the most widely accepted definition of corporate governance, which is contained in the OECD Principles, is aimed at extrapolating the indications that can be drawn, from the *acquis communautaire*, as regards each of the key elements of this definition. Section B, after "reassembling" all indications and presenting a refined definition of (and vision about) corporate governance to be deduced from EC law, addresses some possible objections that can be raised against the arguments submitted, and Section C concludes by indicating – as a way forward - some implications of this refined definition on the approach to the overall analysis of the typical corporate governance issues.

A. The elements of the most widely accepted definition of corporate governance in the light of the Treaty and of the "acquis communautaire"

If one considers the elements of the most widely accepted definition of corporate governance – which is embedded in the OECD Principles - it can be found that each of these elements, *on its own*, has already been dealt with by *specific pieces of EC legislation*, and that the purposes pursued by these legislative measures, together with the provisions of the Treaty concerning the general principles and the activity of business enterprises, presuppose a “vision” about the corporate objective and about corporate governance. This despite the fact that the drafters of the Treaty, written 50 years ago, could probably not imagine that at the start of the new millennium corporate governance was bound to come at the top of the discussions all over the world and to be recognised as one of the essential pillars of the world economy.

The most widely accepted definition of corporate governance – coming from the UK’s Cadbury Report (1992) and subsequently embodied in the OECD Principles, from which it was also referred to by the Commission in its 2003 APCLCG – describes corporate governance as “the system by which companies are directed and controlled”. It clarifies that this system “involves a set of relationships between a company’s management, its board, its shareholders and other stakeholders” and “provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined”. If this (long) definition is “disaggregated” into its individual constitutive components, only *three emerge as the key elements*: the *direction of and the control over* the company’s business activity; the *interrelationships amongst the protagonists* in this direction and in this control; the *objectives* of the business activity. This is because, ultimately, the direction and control of the company’s business activity by its very nature involves a nexus of relationships, i.e., a system of interactions amongst all relevant actors which are listed by the definition, which system, in establishing objectives, must necessarily provides the means for achieving them and for monitoring this achievement in order not to risk being ineffective and self-defeating. The three elements thus absorb all the definition.

The directions of and the control over the company’s business activity, the interrelationships amongst the protagonists, and above all the objectives of the business activity, have been, indirectly, the object of specific pieces of EC legislation and provisions of the Treaty. Although these were laid down with no reference to corporate governance, the achievement of, and the consistency with, their purposes can only be possible if a certain “vision” of corporate governance is set and implemented in companies’ corporate governance models.

Specifically, irrespective of the “soft-law” piece given by the ACPCLCG, the provisions of the Treaty and of secondary EC legislation which, directly or indirectly, reveal an underlying conception about the three key elements which compose the most widely adopted definition of corporate governance can be identified in the Treaty’s provisions laying down the “general principles” of EC law (Arts 2 and 3), in the Treaty’s provisions on the freedom of establishment (Arts 43-48), on the rules on competition (Arts 81-86) and on State aids to enterprises (Arts 87 – 89), and in specific EC directives and regulations issued as part of the company law harmonisation program. The conception which emerges from these provisions is strengthened by other components of the *acquis communautaire*, including some ECJ rulings. For each of the three key elements of the corporate governance definition, the following arguments can be deduced from EC hard law:

A) The company’s ultimate objective

The above indicated Treaty’s provisions, read in the light of each others, unequivocally demonstrate that the drafters implicitly required company’s directors to

consider the *competitiveness of the business as the key objective*, irrespective of the purposes of the company relating to its sector of activity, and, somewhat more expressly, required them to *pursue this objective consistently with social cohesion* and with the *general EC policies aimed at the attainment of socio-economic benefits*. In fact, Art. 2, in listing the EC's tasks, includes both an "high degree of competitiveness" and "economic and social cohesion", without distinguishing between the "macro-level" – that is, the level concerning the relationships between Member States – and the "micro-level", that is the level concerning the relationships amongst companies and between companies and all other socio-economic actors, within any individual Member State too. The lack of this distinction can be deduced from the circumstance that, despite the last part of Art. 2 – when reading "...and economic and social cohesion and solidarity among Member States" – may seem to refer to the macro-level as regards the economic and social cohesion, the other EC objectives indicated in that provision, which by their own nature are essential components of such cohesion (for example, harmonious, balanced and sustainable development of economic activities, etc.), are to be pursued "throughout the Community" and therefore within each of the individual Member States too (and, in the light of the subsidiarity principle ex Art. 5 of the Treaty, actions necessary to achieve these goals need to be undertaken directly by the EC when, by reason of their scale, they cannot be adequately undertaken by the individual Member States). The conduct of companies, competing with each others in the market, is regarded as one of the key components making it possible to achieve these goals. This holds true to such an extent that, amongst the activity of the EC for these purposes, Art. 3 lists "a system ensuring that competition in the internal market is not distorted". This interpretation - whereby, in the Treaty's drafters view, the competitiveness of the business activity, to be pursued consistently with the socio-economic objectives of EC policies, needs to be the key goal of companies' directors – can be further strengthened by the provisions on competition rules and State aids. If they are read *from the viewpoint of what they do not state expressly but implicitly suggest*, both groups of provisions indicate in fact that, outside the few cases which are listed, companies can rely neither on practices restricting the degree of market competition that they normally face, as it can be inferred from Art. 81, nor on State aids in whatever form that threaten this degree of competition, as it can be deduced from Art. 87. In other words, they only need in principle to rely on their own competitiveness in order to survive and prosper in what the Treaty requires to be a competitive market environment, and – having regard to the exceptions which are expressly listed in both Art. 81 and Art. 87 – it can be argued that this competitive environment, rather than being regarded as an absolute value on its own, is implicitly seen as a means towards the promotion of direct benefits to consumers, to local economies etc....in other words, towards the achievements of benefits to all groups which are commonly known as stakeholders. This because the exceptions - indicated in both Art. 81 and Art. 87 - where restrictive practices and State aids to enterprises are within certain limits allowed, imply that, only in those cases, a less competitive or potentially less competitive environment can lead to socio-economic benefits, which latter, in the Treaty's assessment, acquire greater importance, in view of the achievement of the EC goals stated in Art. 2, than a higher degree of market competition. Nevertheless, the market competition – where it can be restricted - must never be eliminated, which was clearly stated by the ECJ (Case 6/72; ECR 1973, p. 215): arguably, in the vision underlying the Treaty's provisions under consideration, the competitiveness of the business activity must, therefore, always be the key goal of companies' directors and,

irrespective of the higher (in principle) or lower (only in the cases of the exceptions laid down by Arts. 81 and 87) degree of competition, *this competitiveness is always supposed to coincide with stakeholders' interests*. Because the environment which makes that competitiveness necessary must always exist, although the degree of competition can be reduced to a certain extent in some cases, directors and managers can, in those cases, avail themselves of a greater range of options (such as cartels, or the request for State aids) in designing their strategic policies. Interestingly, this vision - which appears, from the “corporate governance reading”, to underpin those Treaty’s provisions - whilst it never neglects the interests of the general community, thus of stakeholders, refuses to protect the interests of shareholders in the most evident case where these could be maximised by directors at the expense of stakeholders: the case of abuse of a dominant position, ex Art. 82, when the financial returns to shareholders could be maximised more easily than in any other situation. The prohibition of abuse of dominant position laid down by Art. 82 finds, in fact, no exceptions.

In summary, Art. 2, 3, 81, 82 and 87, taken altogether, offer this indication as regards the objectives of the company, which are one of the three key elements of the most widely accepted definition of corporate governance: *whatever the particular objectives* regarding the sector of activity, the *ultimate corporate objective* needs always be the competitiveness of the business activity of the company, which - because it is supposed to be in line with stakeholders’ interests – must not be pursued in such a way as to damage these interests (as it can be deduced from Art. 82). This interpretation can also be deduced from Directive 2006/68/EC of 6 September 2006, amending the Second Company Law Directive (77/91/EEC of 13 December 1976) on the formation of public limited companies and the maintenance and alteration of their capital: in fact, in its Preamble (Recital 2), this Directive, introduced as part of the implementation of the APCLCG, stresses the objectives of contributing to the promotion of business efficiency and competitiveness without reducing the protection offered to shareholders and creditors (the category of stakeholders under consideration in that particular measure). On the other hand, the emphasis on businesses’ competitiveness can also be found, e.g., in the Commission’s decision to establish the European Corporate Governance Forum, which stressed that “good and transparent corporate governance is essential for enhancing competitiveness and efficiency of businesses in the European Union as well as strengthening shareholders rights and third parties protection (Commission decision to establish the European Corporate Governance Forum, Preamble, Recital 1, 2004/706/EC).

However, two kinds of objections can be formulated against the interpretation suggested.

The first objection can be that Art. 81, Art. 82 and Art. 87 forbid in principle restrictive practice, abuses of dominant position and State aids when there are or there may be adverse effects for competition and trade “as between the Member States”, and that, therefore, a situation in which the competitiveness of the company is pursued – in each individual strategic choice - at the expense of stakeholders’ interests *within an individual Member State* falls outside the scope of any interpretation which may be based on those provisions and, at most, may need to be examined in the light of the concerned Member States’ internal provisions. Nevertheless, such an objection would be unfounded, for a twofold reason. First, the realisation that, given the objectives stated in Art. 2 (and the necessity of reading Art. 81, Art. 82 and 87 in the light of these objectives), the competitiveness of the company needs to be pursued consistently with stakeholders’ interests – as the Treaty supposes the former to be in

the latter' interests - "throughout the Community" and thus, implicitly also throughout the territory of an individual State within the Community, is strengthened by the secondary legislation. In fact, Regulation No. 1/2003 which, in its Preamble [Recital 9], states that although Art. 81 and 82 have as their objective the protection of competition in the market Member States remain free to enact national legislation protecting other legitimate interests, expressly clarifies that this *national legislation need to be compatible with the general principles* - which include Art. 2 and 3 of the Treaty - and other provisions of Community law. This implies that, even in pursuing legitimate interests, other than market competition, which may be peculiar to their own internal situations and may thus be of relevance only to companies operating solely within their domestic jurisdictions, Member States cannot disregard the indications emerging from the said Treaty provisions, amongst which the pursuing of company's competitiveness consistently with (both shareholders and) stakeholders' interests.

Second, the case-law of the ECJ, in interpreting the part "as between Member States", has adopted an extremely inclusive approach concerning the situations covered: the ECJ stated, in a ruling concerning restrictive agreement under Art. 81, that what is sufficient is an influence, direct or indirect, actual or potential, on the patterns of trade between Member States (Case 56/65, *STM v. Maschinenbau*), which must be assessed "with a sufficient degree of probability on the basis of a set of objective factors of law or of fact"; in another ruling, it emphasized the need to interpret the competition rules in the light of each others (Case 6/72, para. 26 and 27, where the ECJ emphasised the necessity of reading both Art. 81 and 82 in the light of Art. 3(f) of the Treaty and as requiring the maintaining of an effective competition structure in the market); lastly in rulings concerning State aids, it added that the non involvement of the recipient in trade between Member States (Case 303/88) and the local or regional character of the activity (Case C-280/00) do not prevent the criteria of the influence on trade between Member States from being met. It can thus be noted that – to the extent that it is not necessary for the activity of the involved companies to imply trade between Member States, and that this activity could even be limited to a local or regional dimension – the ECJ case-law has the potential of making the activity of *any* company fall within the ambit of Art. 81, 82 and 87, even if carried out only within an individual Member State. Inevitably, the greater the development of the company's business, particularly if into a large scale commercial enterprise, the greater the "sufficient degree of probability" which, on the basis of parameters of fact characterizing the activity of all businesses, can suggest a potential influence on trade between Member States, even where all the activity remains within one single Member State. As a result, the greater the extent to which the "vision" about the corporate objective which may be directly extrapolated from these provisions – that is, the competitiveness of the company, to be pursued in such a way as to meet shareholders' interests together with stakeholders' interests – would need to become of relevance also to companies operating within any of the individual Member States.

The second general objection can be that provisions similar to the competition rules of the Treaty – and aimed at protecting the category of stakeholders represented by consumers - can also be found in jurisdictions, outside the EC, where the company law and corporate governance system have traditionally been dominated by the shareholders' centred view. The most significant case that may be cited, in formulating this objection, is that of the USA: it may be emphasised that Art. 81 and 82 of the Treaty "are similar to, and were based on, the American legislation the Sherman Act of 1890, which was set up to control the large trusts in the United

States” (James Hanlon, *European Community Law*, Thompson, 2003, p. 258). Therefore, the objection could be that, if in the USA the “anti-trust” law has not been and cannot be read as calling into discussion the American shareholders’ paradigm in company law and corporate governance, the competition rules in the EC could not be used to draw an interpretation about a corporate governance “vision” implied in the Treaty. Nevertheless, this objection would fail to consider that, unlike the American anti-trust law, the competition rules of the Treaty, the secondary legislation adopted thereof and the ECJ case-law *need to be read not only in the light of the EC goals stated in Art. 2 and 3* (social cohesion, sustainable development), which find no correspondents in the USA Constitution or in its amendments [although the USA Constitution, in its Preamble, refers to justice and general welfare, this Preamble do not grant any power and only explains the rational behind the Constitution, and may be compared to the Preamble to the Treaty, whereas Arts 2 and 3 of the Treaty, even if included amongst the “Principles”, set out the specific purposes and activities to be undertaken] *but also in the light of at least another provision which the drafters of the Treaty laid down in view of the same ultimate goals.*

This provision can be found in a Treaty’s article on the freedom of establishment, Art. 44 (2)g. The provision, which has been the legal base of the EC company law harmonisation program, requires the Commission and the Council to coordinate “to the necessary extent the *safeguards which, for the protection of the interests of members and others, are required by Member States of companies and firms.....with a view to making such safeguards equivalent throughout the Community*” (emphasis added). From the corporate governance perspective, the important parts in this provision are “to the necessary extent” and “interests of members and others”. Taken together, they raise the question whether the Treaty’s drafters wanted the protection of the interest of members and others to be coordinated only to the extent required for facilitating companies in moving from one State to another, or whether “members and others” need be read as referring to a “shareholders and stakeholders” protection which is assumed in any case, as a part of the *end* of corporate governance, to pre-exist in all Member States and whose *instruments* and/or *degree* have to be coordinated to the necessary extent for making it easier companies’ freedom of establishment. The conceptual difference between the two interpretations is substantial. In the former case, within individual Member States, either shareholders and stakeholders’ interests could be attached equal importance in the design of corporate governance systems, or one category of interests (e.g., shareholders’ interests) could be given priority over another (stakeholders). This provided that the *protection* of both categories of interests is coordinated, from one Member State to another, to the extent that is necessary for facilitating companies’ cross-border establishment. In the latter case, all individual Member States would need, a priori, to share the same underlying “values” in terms of protection of the two categories, and the *means* to achieve an equivalent degree in this protection would need to be made equally effective, by means of coordination of the national provisions, for facilitating companies’ freedom of establishment. In other words, whereas in the former case this provision would not contribute to the extrapolation of a general “vision” of corporate governance, and of an identification of the corporate objective, implied in the Treaty, in the latter case it would be important in doing so. Two ECJ rulings concerning the application of the first company law directive, which (as the subsequent company law directives) was based on Art. 44(2)g, together with an historical reality existing at the time of the drafting of this Treaty’s provision (which was never amended), make it possible to deduce which interpretation, amongst

the two, is likely to be the correct one. In Case C-104/96, *Cooperatieve Robobank* ECR 1997 I-7211, the ECJ held that the rules governing the enforceability as against third parties of acts done by members of company organs in circumstances where there is a conflict of interests with the company fall outside the normative framework of the first directive and are matters for the national legislation. The ECJ, in formulating this statement, was dealing with a situation where, under a national provision, a company was allowed to rely, as against a third party with whom a director generally authorised to represent the company has entered a transaction, on the circumstance that the directors lacked authority due to a conflict of interests, caused by the transaction, between him and the company. Considered on its own, this decision, as it was noted (Dine, 2001), reduces dramatically the reach of the first company law directive in protecting third parties. Nonetheless, in a quasi – simultaneous ruling concerning the application of the same company law directive, Case C-97/96, *Daihatsu Deutschland*, ECR 1997 I-06843, the ECJ had clarified the scope of Art. 44(2)g. It had stated that this provision needs to be read in the light not only of other Treaty’s articles on the freedom of establishment, but also of Art. 3(h) which provides that the activities of the EC are to include the approximation of national laws to the extent required for the *functioning* of the common market. The ECJ, in the context of this ruling, in which it rejected a submission whereby in Art. 44(2)g “others” means only “creditors”, also added that “*furthermore, the very wording of Art. 44(2)g refers to the need to protect the interest of others generally, without distinguishing or excluding any categories falling within the ambit of that term*” (paragraph 19). The two rulings, taken together, give rise to the question if and how they can be reconciled: in one case (*Robobank*), the ECJ had left in place, as a matter for national legislation, a national provision which could adversely affect third parties; in another case (*Daihatsu Deutschland*), it had stressed the need to protect the interests of all third parties (“others” generally). A response can be found if analysing the scope of the ECJ statements in *Daihatsu Deutschland*. These statements need to be considered only in the context of companies’ business activity, for it is this activity which affects the functioning of the common market (referred to by Art. 3h) and which may contemplate the exercise of the freedom of establishment (referred to by Art. 43 et seq.) as part of its strategies. As a result, the categories falling in the ambit of the term “others” also include - in addition to creditors - employees, suppliers (of raw materials, of products, of finance), customers, local communities and governmental authorities to the extent that all these categories concretely contribute to the life of the company, in consequence get benefits from this activity and, thus, can be defined as stakeholders. This implies that, ultimately, the clarification of the scope of Art. 44(2)g in the above ECJ statement requires Art. 3(h) to be intended as if it read “the activities of the EC include the approximation of *national laws which concern the protection of the interests of companies’ shareholders and stakeholders* to the extent required for the functioning of the common market”, where, however, to be *approximated to this extent*, national laws concerning the protection of the interests of shareholders and stakeholders must, *on the whole*, either *pre-exist* or be *first introduced* in any individual Member State. Consequently, the response to the question how the two rulings can be reconciled can be as follows: a national provision adversely affecting third parties (stakeholders) may remain outside the scope of a directive aimed at approximating only to a certain extent national laws concerning the protection of third parties, *provided that the (pre-existing or newly introduced) national provisions of the State concerned, on the whole*, offer a protection of all third parties as effective as those offered in other Member States and thus consistent with

the proper functioning of the internal market, which market, in turn, functions (properly) when, *throughout the Community* (and thus, again, throughout any Member State too) the ultimate EC goals stated in Art. 2 are achieved. In addition, an historical data needs to be considered: at the time of drafting of Article 44(2)g, whose wording has remained unchanged since then, all six founding Member States used to require companies incorporated in their jurisdiction to maintain there the effective seat, in other words the principal place of business, according to the so-called “real seat” criteria which historically found its justification in the effective protection of all third parties involved in company’s affairs. Moreover, as extensively discussed elsewhere, in its case-law concerning companies’ freedom of establishment the ECJ, although it appears in principle to have struck down the real seat criteria, it also has been regarding the protection of the interests of creditors, of employees, of minority shareholders, of the effectiveness of the fiscal supervision - shortly the importance of the protection of the categories known as stakeholders – as necessary: in other words, the ECJ has been recognising the objective lying behind the real seat criteria originally adopted in all founding Member State at the time of the Treaty drafting, and has only regard this criteria as an inappropriate means to achieve those key objectives [L.Cerioni, *EU Corporate Law and EU Company Tax Law*, Edward Elgar, forthcoming in 2007; amongst the vast body of literature, inter alia: Leible and Hoffman, ‘*Überseering*’ und das (vermeintliche) Ende der Sitztheorie’, 48 RIW (2002) pp. 925. De Kluiver, ‘Inspiring a New European Company Law? – Observations on the ECJ’s Decision in Inspire Art from a Dutch Perspective and the Imminent Competition for Corporate Charters between EC Member States’ 1 ECFR (2004) pp. 121]

All this indicates that the second interpretation above formulated about the wording “to the necessary extent” and “members and others” in Art. 44(2)g – that is, the reading whereby the approximation need to be intended as regarding the instruments, whereas the underlying values concerning the protection of stakeholders are assumed to coincide - is the one implicitly accepted in the Treaty. It follows that a situation where in one Member State the interests of stakeholders are supposed to be to some extent in contrast with those of shareholders and are protected only to the extent that is regarded as instrumental towards the protection of shareholders’ interests, and in another Member State the interests of both shareholders and stakeholders are regarded as deserving protection to the same extent, would not be *fully in line* with the “corporate governance conception” underlying the Treaty. However, it could be *acceptable* under this conception only if in the two States, despite the different underlying national conceptions, *in practice the protection of stakeholders’ interests turns out being equally effective, as this would by definition not distort the functioning of the market*. If this were not the case and the risk of distortions, by its scale, could not sufficiently be eliminated by measures introduced by Member States – which assessment would need to be carried out by the Commission - the EC could issue directives to approximate national laws, in accordance with the subsidiarity principle. In fact, *an approximation of national laws* concerning the protection of stakeholders’ interests aimed at *avoiding distortions in the functioning of the market* would in that situation be required to protect also the possibility of competitiveness of all business located in different Member States, which competitiveness is – as it is indicated also by Treaty’s provisions concerning rules on competition and State aids – regarded as consistent with (shareholders and) stakeholders’ interests.

This conclusion is not given the lie by the fact that the company law harmonisation Directives issued to date on the basis of Art. 44(2)g has been mainly aimed to protect

shareholders and creditors [for the updated list of all Directive, see EU Website], because this can be seen as a *limited use made up to the present time of the overall scope of this provision*, which certainly does not prevent Art. 44(2)g from being used as a base for introducing further EC measures aimed at protecting all stakeholders' interests.

B) The directions of and the control over the company's business activity

Whereas the Treaty's provisions of Art. 2, 3, 44(2)g, 81,82, 87 lend themselves to be interpreted in such a manner as to identify the corporate objective in the competitiveness of the business activity in the interest of both shareholders and stakeholders, other directives and regulations highlights a specific vision about the two other key components of the most widely accepted definition of corporate governance.

As regards the direction of the company's business activity and the control over it, which are essential in achieving the competitiveness objective, important indications can be drawn from the accounting Directives introduced as part of the company law harmonisation program, as well as from recent Regulations adopting certain international accounting standard (IAS) principles.

The Fourth Company Law Directive [Directive 78/660/EEC of 25 July 1978, amended by Directive 2006/46/EC of 14 June 2006] on annual accounts of public limited companies, of private limited companies and of certain types of partnerships when all their members are limited liability companies, which was based on Art. 44(2)g, recognises in its Preamble that the co-ordination of national provisions concerning the presentation and contents of annual accounts and annual reports, the valuation methods used therein and their publication is of *special importance* for the *protection of members and of third parties*. In so doing, it explains that simultaneous coordination is necessary in these fields because, on the one hand, these companies' activities frequently extend beyond the frontiers of their national territories and, on the other hand, they offer no safeguards to third parties beyond the amounts of their net assets. Whereas the extension of the activity beyond national frontiers may be the result of the exercise of the freedom of establishment within the EC, the express recognition that companies offer no safeguards – to be intended, evidently, as economic and financial safeguards – to third parties beyond the amount of their net assets holds true also in respect of companies operating *only within one individual Member State*, and thus confirms that “the protection of the interests of members and others” in Art. 44(2)g is to be read as referring to the “interests of shareholders and stakeholders” also within any Member State. Moreover, it must be noted that, because the “amount of the net assets” - that is, of the value of assets minus the values of liabilities, where the profits made during a given financial period increase the value of the assets and the losses suffered during the period decrease it - is indicated as third party's (economic and financial) safeguard, *third parties' (stakeholders) interest is implicitly assumed to coincide with the economic and financial health of the company*. The amount of net assets, which, if analysed over time, gives an indication of the economic and financial situation of the company, is – to a large extent - the *direct result of the company's direction*, which generates stakeholders' responses to the choices made by this direction, and *of the control over this direction*. A successful company *direction*, which manages to obtain profits in each period of measurement, also ensures that the amount of net assets remains positive from one period to another and, in so doing, manages to reconcile shareholders' interests (“long-term

shareholders' value") with (what the Directives implicitly assume to be) stakeholders' interests. The same role, in achieving this outcome, is played by the *control* over the companies' direction, as this control, in identifying the causes that in a given period of measurement may have generated a loss, and the most appropriate actions to be undertaken to redress the situation (whose cause may well lie in the dissatisfaction of one or more groups of stakeholders during the period at issue), can become the decisive element, for example, for turning over time a negative amount of net assets into a positive one. This interpretation, which supposes *the survival and development of the company's business activity*, is directly confirmed by Art. 31 of the Directive, dealing with the "valuation rules" (without which the net amount of assets could not be calculated): as a first general principle, in fact, "the company must be presumed to be carrying on its business as a *going concern*". All valuation rules which are established under this provision are instrumental towards the Directive's objective, which is to offer third parties a "true and fair view" of the companies' situation, and of the evolution of this situation over time: interestingly, third parties' interests are *always* – that is, with no exceptions - assumed to coincide with the economic and financial "health" of the company, which economic and financial health can be verified only if the accounts manage to offer a true and fair view *either with or without the compliance with a particular valuation rule*. In other words, the valuation rules are assumed to be normally able to determine the economic and financial situation but, if in exceptional cases they fail to do so, in those cases, under Art. 31,2 paragraph, they must not be applied because their application would, in such situations, conflict with (both shareholders and) stakeholders' interests. This can be clearly deduced from a leading ECJ ruling (Case C-275/97, DE-ES, 1999, ECR I-5331), concerning the application of one amongst the valuation rules, whereby the components of asset and liability items are to be evaluated separately. The ECJ stated that the exceptional cases where departure from this rule is permitted are those in which separate valuation would not give *the truest and fairest possible* view of the financial position of the company concerned. Accordingly, the interest not only of shareholders but also of stakeholders is assumed to coincide with the economic and financial health of the company to such an extent that, in case of different valuation rules all giving what can be considered *true and fair views*, those leading to the *truest and the fairest* view must be adopted: in effect, the truest and fairest view is the one which, by leading to the most precise and accurate information on the company's economic and financial state of health, best allows both shareholders and stakeholders to assess to what extent the direction and control of the company's business activity has managed to satisfy their interests in the economic and financial performance of the company. The fact that these interests lie in both the economic and the financial "health" of the company can also be deduced from the same ruling, where the ECJ has identified the directive's aim in the true and fair view (intended thus as the truest and fairest view) of their assets and of their financial position, which, on the whole, illustrate the financial situation of the company, and of their profit or loss, which indicate the economic position. Two other provisions of the Fourth Directive, Art. 28 and Art. 29, which are also made applicable, by the Seventh Directive (Directive 83/349/EEC of 13 June 1983), to consolidated accounts, can add further contents to the notion of "economic and financial health" of the company's business activity. Art. 28, in specifying that the net turnover comprises the amounts derived from the sale of products and the provision of services falling within the *company's ordinary activities*, and Art. 29, in requiring that income and charges arising otherwise than in the course of the company's ordinary activity must be shown as "Extraordinary

income and extraordinary charges” and that, *unless they are immaterial for the assessment of the results*, these income and charges must be explained in their amount and in their nature in the notes on the accounts, implicitly suggest the criteria which should guide the direction of the company (and the control on this direction). This should be, from one financial year to another, that of obtaining profits from the company’s *ordinary business* activity rather than from extraordinary – and thus not typical – sources of profit: it can be deduced from the provision that, in the assessment of the results, the distinction between ordinary business activity and extraordinary income and charge items is important. When extraordinary income and charges become relevant, by reason of their amount and their nature, in obtaining an overall earning of 100, this result cannot, in fact, be assessed in the same way as in the case when – given the same amount of 100 or even a lower amount - the relevant source lie in the company’s ordinary business activity: this because only the ordinary business activity can ensure, by definition, the survival and development over time of the company’s business, which latter as shown above is supposed to be in the common interest of both shareholders and stakeholders.

In turn, the internationally accepted accounting principles (IAS), which, at least for consolidated accounts of publicly traded companies, have been adopted by the EC Regulation 1606/2002 and by other Regulations introduced thereof [e.g., Commission Regulation 1725/2003], specify the *rules to be applied in identifying the sources of the overall economic result* (which affects the financial situation too) and *thus the part of this result originating from the ordinary business activity*: these principles, as stated in the Preamble to the recent Directive 2006/46/EC, are regarded as resulting in the true and fair view about the situation of these companies (Directive 2006/46/EC, Preamble, Recital 11) as going concerns.

To sum up: the Fourth Company Law Directive, complemented by other accountancy-related pieces of secondary legislation such as the Seventh Company Law Directive and the Regulations introducing the IAS, is interpretable in such a way as to draw clear indications about the direction of the company’s business activity and the control over this direction: this needs to be oriented to an *objective and measurable result* which is assumed to satisfy the interests of shareholders as well as of stakeholders. This result can be summarised in the attainment, and in the sustainability over time, of *sound economic and financial conditions*, which are the necessary requirement in order for the business activity to be a “going concern”: as implied in the above analysed Fourth Directive’s provisions, these conditions exist, on the one hand, when the economic result of the activity derives (mainly) from the company’s *ordinary business* (*sound economic conditions*); on the other hand (and as a consequence), when this kind of economic result consistently allows, from one financial year to another, the financial resources which the company generates and on which can rely in the medium-long run (ultimately, its assets) to be higher than the liabilities that the company incurs in making the investments which are necessary to carry out its activity and whose returns are also expected in the medium-long run (*sound financial conditions*).

It could be objected that legal and accounting rules requiring the annual accounts to give a “true and fair view” and, in the preparation of annual accounts, to consider the company as a “going concern” have always been normal (and it could not be otherwise) in Anglo-Saxon countries where the corporate objective has in general been indicated in the maximisation of shareholders’ wealth (shareholders’ primacy approach), and where the direction of the company has been supposed or required to rank interests (shareholders over other stakeholders); to this objection, it could be

added that the concept itself of “true and fair view” comes from Anglo-Saxon accounting standards. Nevertheless, this criticism would “forget” to consider that, once “transferred” in the context of EC law through the accounting Directives such the Fourth Directive, the provisions at issue need to be read, like those of any other piece of secondary legislation, in the light of the overall Treaty’s stated goals – increasing standards of living, employment level, social cohesion – which, per se, *imply that companies need to be run in such a way as to remain “going concern” for the benefit of both the shareholders and the stakeholders community* (the Fourth Directive Preamble, like that of any other piece of secondary legislation, says “Having regard to the Treaty, and *in particular* to Art. 44(2)g”, where *in particular* implicitly means *not only* to Article 44(2)g). In effect, only if companies continues to be “going concern” is possible, for shareholders and stakeholders throughout the EC, to give their continuous contribution and to keep obtaining the related benefits over time. This is consistent with the *special importance* to the protection of members and third parties attached to the rules concerning the annual accounts and to their co-ordination, and with a further indication that can be drawn if comparing the Fourth Directive, concerning companies *as going concerns*, with a piece of legislation such as Regulation 1346/2000 on insolvency proceedings, concerning companies *at the end of their existence*. Regulation 1346/2000 allows the insolvency proceeding opened in the Member State of the insolvent company to have universal scope and to have effect within the Community: stakeholders’ interests also need to be protected at the end of the company’s existence, when each group has claims on the remaining assets, and the Preamble to Regulation 1346/2000 indicates objectives in terms of protection of creditors, of employees and jobs etc...However, it can be noted that – in contrast to the statement contained in the Preamble to the Fourth Directive – the Preamble to Regulation 1346/2000 does not indicate that the protection at the time of insolvency of creditors and employees rights, however certainly important, is of *special importance* for the interests of third parties. It can also be noted *that the legal basis of Regulation 1346/2000 only lies in Articles 61 © and 67 (1) of the Treaty*, dealing with judicial cooperation in civil matters, and not in *both these Articles and Article 44(2),g*. This *despite the fact that a company which has become insolvent but with assets and activities in more than one Member State has exercised the right of establishment and that, ultimately, Regulation 1346/2000, by dealing with the effects of insolvency procedures opened in one Member States, also coordinates safeguards for the protection of members and others*. Implicitly, this suggests that the protection of the interests of both members and third parties throughout the EC to a *continued existence of the company* (whose conditions need to be monitored through the annual accounts), and to a long-term relationship with it allowing them to extract over time the benefit from their contributions, *is regarded as being of a qualitatively different importance* (“special importance” rather than simply “importance”) - such as to deserve an approximation of rules within the Community - *from the protection of the interest to get, at a time when a long-term relationship is bound to be prevented from the insolvency and the disappearance of the company, the return in that particular time* (which, rather than an approximation of the substantive rules, deserves in the legislative assessment of the EC a coordination by means of a simple extension of the effects of an insolvency procedure opened in a Member State).

C) *The interrelationships amongst the protagonists*

It could be a common belief that, if considered on their own, the interrelationships

between a company's management, its board, its shareholders and other stakeholders may result in either the protection of one category of interests with priority over another, or in the protection of both. At first sight, it would seem that, in this respect, EC law leaves the relevant choices to Member States and to company's management. This interpretation might be based on two realisations. First, the regulation of the two "supranational" company law vehicles to date created, that is the European Company (SE) introduced by Regulation 2157/2001 and the European Cooperative Society (SCE) introduced by Regulation 1435/2003, leaves to the company's statutes the choice between alternative types of corporate governance structures – a one-tier structure (board of directors) or a two tier management structure (supervisory board and board of directors) – which are found in systems typically regarded as characterised by different approaches concerning the interests to be protected (Anglo-American system vs. continental Europe system) [see Title III of Regulation 2157/2001, in particular with Section I (two-tier system: Articles 39 to 42) and Section II (one-tier system) in particular with Section I (two-tier system: Articles 39 to 42) and Section II (one-tier system: Articles 43 to 45), and Chapter III of Regulation 1435/2003 (Articles 36 to 51), in particular Section I (two-tier system: Articles 37 to 41) and Section II (one-tier system: Articles 42 to 44)]. In its supplementing Directives which concern employee involvement in the company's decision-making, Directive 2001/86 (complementing Regulation 2157/2001) and Directive 2003/72 (complementing Regulation 1435/2003), the regulation of the SE and of the SCE also leaves one of the key categories of stakeholders, the employees, with either rights to participation or rights to information and consultation, which gives them different possibilities of exercising an (effective) influence on decisions to be taken by the company according to the Member State of location of the company. It may be noted that the same approach concerning employee involvement underlies the 2005 Directive on cross-border mergers of limited liability companies (Directive 2005/56/EC), which has been introduced as a part of the implementation of the APCLCG and according to which the principles and procedures provided for in Regulation 2157/2001 and in Directive 2001/86 are to be taken as a basis (see, in detail, Preamble to Directive 2005/56/EC, Recital 13). Second, the Commission, in the APCLCG placed particular emphasis on shareholders' rights (p. 13-14), while devoting only a mention to "third parties protection" (p. 8).

Nevertheless, the emphasis placed on the APCLCG on shareholders' *rights* gives no evidence that the Commission, in this important soft-law piece dealing with corporate governance and setting the agenda for the latest Directives [which have subsequently been introduced: 2005/56/EC; 2006/43/EC; 2006/46/EC; 2006/68/EC], intended to consider shareholders' *interests* as diverging from stakeholders' *interests* and to prioritise the former over the latter. In fact, it recognised that a "sound framework for *protection of members and third parties*, which properly achieves a high degree of confidence in business relationships, is a fundamental conditions for *business efficiency and competitiveness*" (COM 284[2003], p. 8), and, when noting that forty or so corporate governance codes relevant to the EU have been adopted over the last decade, at national or international level, with the aim of better protecting the interests of *shareholders and/or stakeholders* (p. 10), it only described the situation resulting from initiatives undertaken by Member States. An analysis of this situation, examined by a study contracted out by the Commission, led it to conclude that there is no need for a European corporate governance code (p. 11), basically due to a remarkable degree of convergence of national corporate governance codes. Despite this convergence in corporate governance codes, the Commission noted the

differences existing between Member States in company laws and securities regulation – which differences may result in different degree of protection of shareholders and stakeholders within the EC (contrary to what the Treaty would presuppose: see above, A) - and it identified the role to be played by the EC in the field of corporate governance in the development of a common approach with respect to few essential rules and in the coordination of (national) corporate governance rules. This for the purpose of providing “equivalent protection for shareholders and other parties concerned with companies” (as the Commission literally states: see the relevant page in the Commission’s Web Site, at: http://ec.europa.eu/internal_market/company/index_en.htm).

In this context, the meaning of the expression “*equivalent* protection” can be understood in the light of two recent Directives issued in the context of the implementation of the initiatives planned in the APCLCG: the Directive on Statutory Audit (Directive 2006/43/EC of 17 May 2006), which amends the Fourth and the Seventh Directives and repeals the 1984 Eight Directive on audit, and the “transparency” Directive, which further amends the Fourth and the Seventh Company Law Directive by imposing collective responsibility of board members for financial information and by requiring listed companies to disclose an annual corporate governance statement (Directive 2006/46/EC of 14 June 2006). The former Directive, in addition to strengthening the requirements of independence and ethical standards of external auditors or auditing firms, requires listed companies, and other “entities that are of significant public relevance because of the nature of their business, their size or the number of employees” that can be designated by Member States (Preamble, recital 13), to have an “internal audit committee” which must, *inter alia*, *monitor the effectiveness of the company’s internal control, internal audit where applicable, and risk management system*. The reason is clearly explained in the Directives’ Preamble, which states that “*effective internal control systems contribute to minimise financial, operational and compliance risks and enhance the quality of financial reporting*” (Preamble, recital 24). The latter Directive, in requiring the collective responsibility of members of the administrative, management and supervisory body *towards the company* for the drawing up and the publication of financial information (Art. 1, 8th paragraph, Session 10A, Art. 50b), specifies that Member States can go further and provide for *direct responsibility* towards shareholders or even other stakeholders (Preamble, recital 2), and it imposes the corporate governance statement to contain, *inter alia*, “a description of the main features of the company’s internal control and risk management systems in relation to financial reporting process”. (Art. 1, 7th paragraph, 46a, let. c).

These provisions, if read together, indicate that the interrelationships between the protagonists of the nexus of relationships which compose a corporate governance systems *should develop in such a manner as to manage, for the purpose of minimising it, the overall risk inherent in the company’s business activity*, particularly as regards companies (such as the listed ones) carrying on large scale commercial enterprises, which risk, in addition to be managed through internal systems and controlled, need to be reflected in the financial reporting. Specifically, this risk can derive: from the company’s performance, where it is bound to be lower the higher the satisfaction of stakeholders, from whom the company’s success depend (operational risk); from the financial position of the company (financial risk), which ultimately turns out being interlinked with the economic results, which latter, in turn, depends on the company’s performance and need to reflect it for indicating the trend of the company’s ordinary activity; from the risk of not complying with legal requirement (compliance risk),

where compliance turns out being more onerous for company's in poor (economic and) financial conditions. Ultimately, the greater the extent to which this overall risk is successfully managed, the greater the company's chance of surviving and developing over time under sound economic and financial conditions; however, for this risk to be successfully managed, it must be minimised through effective internal control systems and, in each financial year, it must be reflected in the financial information. Financial information reflecting a substantial degree of risk at the end of a given financial year can, thanks to an effective internal control and risk management system, lead to corrective actions capable of modifying the working of the interrelationships between the protagonists in order to reduce the risk incumbent on the company's business activity. The interest of the company in the "truest and fairest" financial information (v. supra) delivered through an effective system of internal control and reporting, *without which the actions leading, in ultimate analysis, to the achieving and maintaining of sound economic and financial conditions could not be undertaken*, is such that the collective responsibility of all board members towards the company is imposed to safeguard this interest: the fact that Member States can, *in addition*, impose direct responsibility of board members towards (individual) shareholders or even stakeholders suggests that no ultimate interests of shareholders and stakeholders is supposed to exist other than the objective interest in the survival and development of the company's business activity under sound economic and financial conditions. In other words, it can be deduced that, in this EC legislation, the safeguard of this interest is assumed to *protects in an equivalent way*, in addition to the company, *also its shareholders and its stakeholders*: the circumstance that Member States may add, to the accountability towards the company, that towards the shareholders and even towards the stakeholders demonstrate (together with the coincidence of interests) that, in the Directive's assessment, *additional ways of enforcement* of the board's accountability for the same result may lead to a more effective protection of all interested parties indicated in the definition of corporate governance, including the management. This latter can, in fact, ultimately avail of a criteria to inspire its decisions, in the running of the business, in the choice of the short-term and long-term policies.

The "equivalent protection for shareholders and other parties concerned with companies" can thus be seen, ultimately, as the guiding criteria for the interrelationships between shareholders, managers, and other stakeholders, and it needs to be understood on the one hand as *the achievement of an objective result which equally protects all interests* and, on the other hand, *as equivalence in the safeguard of this result from one Member State to another*.

This does not contrast with the choices made in the regulation of the SE and of the SCE regarding the one tier or two tier board structures and the different degree of an effective possibility of employees' involvement in the decisions taken by the company, but rather explains those choices. In fact, the equivalent protection for shareholders and stakeholders can be easily reconciled with those choices: this equivalent protection, intended as achievement of a result which equally protects all interests and as equivalence in the safeguard of this result in all Member States, is the *end* which needs to guide the interrelationships between the protagonists, whereas the possible different choices concerning the board structures and the degree of employees (and other stakeholders) involvement are only the alternative *means* towards this end, *which are all allowed to the extent that they are supposed to be equally effective*.

D) The definition of corporate governance emerging from EC (hard and soft) law “reassembled”: the corporate objective, the directions and control of the company’ activity, the interrelationships

In the light of the previous analysis of the indications that, from EC hard law and from the APCLCG, emerge as regards each of the key elements of the most widely accepted definition of corporate governance, it may well be argued that the Commission, when in the part of the APCLCG devoted to corporate governance recalled, in a note (see p. 10, paragraph 3.1.), after quoting the OECD Principles, that “Corporate governance essentially focuses on the problems that result from the separation of ownership and control, and addresses in particular the principal-agent relationship between shareholders and directors”, had a limited purpose. In other words, the Commission intended only to remind the issues on which corporate governance debates and literature generally focus, without attempting to give it a focus to be deduced from EC law. In effect, the indications which can be deduced from the relevant EC law, as regards each of the key element of the definition of corporate governance, hold valid both in situations where there is a separation of ownership and control, and in situations where there is no such separation. Though the APCLCG is not yet completely implemented, the Directives which have been to date issued on the basis of the APCLCG, red together with the other Directives and with the Treaty, all offer indications that apply whatever the ownership structure of the company.

Consequently, irrespective of whether or not the company is characterised by the separation between ownership and control and irrespective of the jurisdiction in which it operates, if the indications that can be deduced from EC law regarding each of the elements of the definition of corporate governance are read all together it can be argued that:

- a) the corporate objective needs to be identified in the competitiveness of the company’s business activity, which competitiveness, by resulting in the survival and development of the business under sound economic and financial conditions, is supposed, per se, to satisfy both shareholders and stakeholders’ interests;
- b) the sound economic and financial conditions, which are objectively and easily measurable from one financial year to another, presuppose a concept of *profit making* based on the *quality of the profit*, that is the sustainability over time of profits coming from the company’s *ordinary* activity [supra, point B] which, ultimately, would not be possible without the satisfaction of stakeholders, i.e. without stakeholders’ (express or implicit) assessment of directors’ choices as protecting (also) their own interests;
- c) this quality of the profit can be ensured to an higher extent the greater the degree to which stakeholders, considering directors’ choices as protecting also their interests, ensure a continuous contribution to the life of the company (where the type of contribution depends on the stakeholder groups, so that customers would continue to buy the companies’ products or services, employees would remain “loyal”, etc.);
- d) the direction of the company’s business activity, and the control over it, needs to assume the (achievement and sustainability of) sound economic and financial conditions, and the underlying concept of quality of profit, as its guiding criteria in all the strategic choices and in the subsequent short-term

operational decisions to be undertaken consistently with these strategic choices;

- e) the interrelationships between the protagonists should be arranged in such a manner as to minimise the overall (operational, financial and compliance) risk of compromising the survival and development of the business under sound economic and financial conditions, and a control system should be implemented to monitor, for this purpose, the developments of these interrelationships.

It may be easily noted that the notion of profit making based on the above concept of quality of profit, does not necessarily indicate the idea of *maximization of profit*, which idea inevitably refers to the *quantity of profit*. In other words, having regard to the distinction (which emerges from the Fourth Company Law Directive) between the company's *ordinary* business activity – which needs to survive and to develop over time for the company to remain a “going concern” - and the extraordinary items of income and expenses which can be obtained/incurred in the course of the *overall* activity, and to the necessity of identifying a precise length of time within which to identify if the profit is maximized, it becomes evident that the concept of “profit maximisation” ends up indicating the amount of profit, whether coming from the ordinary activity or from extraordinary operations, obtained in a specific period of time. The shorter the period of time considered, the easier it becomes to assess if the profit is maximised, where maximisation indicates *the exploitation of all opportunities, known to directors in that specific period of time*, to increase the amount of the overall profit in the period. To the extent that this exploitation of all opportunities may lead to actions that will be perceived by stakeholders as in contrast with their interests, the contribution of stakeholders over time risks being withdrawn and the sound economic and financial conditions compromised, although in the period of time the actions undertaken by directors may allowed shareholders to obtain the highest possible amount of monetary profits.

The interpretation whereby this idea of profit maximisation is inconsistent with EC hard law is in line with the view expressed by the Commission in a soft law piece, the Commission's Communications on Corporate Social Responsibility (CSR). CSR has various definitions at international level, such as, on the part of the Commission, “a concept whereby companies integrate social and environmental concerns in their business operations and in their interaction with their stakeholders on a voluntary base” [COM(2002)347final, “A business contribution to Sustainable Development”; COM(2006)136final, “Implementing the partnership for growth and jobs: making Europe a pole of excellence on corporate social responsibility”], or, on the part of the World Business Council for Sustainable Development, “the continuing commitment by businesses to behave ethically and contribute to economic development while improving the quality of life of the workforce and their families as well as of the local community and society at large”. It is, in any case, evident that all these definitions, between the idea of profit making over time based on the quality of profit resulting from the protection of the interests of all stakeholders, and the idea of profit maximisation based on the amount of profit as measured in a specific period, are consistent only with the first idea. This because the definitions emphasize an aspect – the satisfaction of the interests of stakeholders – that only the concept of *profit of quality*, suggested by the *acquis communautaire*, presuppose as a requirement for the sustainability over time of sound economic

and financial conditions and, with them, for business (sustainable) competitiveness. In effect, the Commission, in its Communication on CSR [COM (2006) 136 final, “Implementing the partnership for growth and jobs: making Europe a pole of excellence on corporate social responsibility”], has expressed the view that that “CSR mirrors the core values of the EU itself”. To the extent that these values are reflected in the law, and in primis in the Treaty as a primary source of EC law, the Commission has thus implicitly recognised that CSR is implied in EC law which concerns the “Community pillars” of the EU.

Moreover, the interpretation according to which an objective of maximisation of profit for the sole benefit of shareholders, which underlies any conception relying on the concept of ranking of interests (shareholders interests as paramount, and stakeholders interests to be pursued only to the extent that promotes those of shareholders), does not “fit in” with the conception underlying the Treaty and EC hard law, appears to be in line with two (further) “soft-law” pieces issued in the context of the implementation of the APCLCG, if they are read in the light of each others and in the context of the APCLCG itself: the 2004 Commission Recommendation on “fostering an appropriate regime for the remuneration of directors of listed companies” [Commission Recommendation of 14 December 2004, 2004/913/EC, fostering an appropriate regime for the remuneration of directors of listed companies], and the 2005 Commission Recommendation on the role of non-executive or supervisory directors of listed companies and on the committee of the (supervisory) board [Commission Recommendation on the role of non-executive or supervisory directors of listed companies and on the committees of the (supervisory) board of 15 February 2005, 2005/162/EC].

After taking note, in the APCLCG, that according to the comprehensive OECD definition corporate governance is usually understood as the system by which companies are directed and controlled and that it involves “a set of relationships between a company’s management, its board, its shareholders and other stakeholders”, the Commission implicitly assessed the position of one of these actors – the board of directors of listed companies – in respect of those of two other categories of actors, shareholders and other stakeholders. In so doing, it considered, in the two Recommendations, the position of both executive directors and non executive directors. With regard to executive directors, the 2004 Recommendation – which requires the disclosure of a “statement of the remuneration policy” of the company – specifies that this statement should explain, among other, the company’s policy with regard to the duration of contracts with executive directors, the applicable notice periods and details of provisions for termination payments (Section II, 3.3.); it also recommends that, in the case of share-based remuneration, any scheme contemplating remuneration in shares, share options or any other right to acquire shares or be remunerated on the basis of share price movements should be subject to the prior approval of shareholders (Section IV, 6 and 7). It may be deduced, from these recommendations, that the Commission probably assumed executive directors to be appointed for a shorter or longer term time period and not be shareholders when taking office: on those basis, it reasonably assumed that *these directors may have an interest to maximise their remuneration during their term of office and to enjoy the widest possible discretion, which interest would conflict with that of shareholders*. Accordingly, the 2004 Recommendation clarifies that: as for the remuneration policy, the statement should set out inter alia sufficient information on the performance criteria behind any entitlement to shares options, shares or

variable components of remuneration, on any linkage between remuneration and performance (Section II, 3.3.); as regards the remuneration of individual directors, a disclosure of each component of this remuneration and/or emolument, including any additional remuneration for extra-services and non cash benefits, the relevant information should be disclosed in detail in the annual accounts or in the notes to the annual accounts or in the remuneration report (Section III, 5); lastly, as regards share-based remuneration, that information should be made available to shareholders about how the company intends to provide for the shares needed to meet its obligations under incentive schemes and about the costs of the schemes to the company (Section IV, 7). In turn, the Recommendation Preamble (Recital 2) states that shareholders' competence concerning the form, structure and level of the remuneration should facilitate the recruitment and retention – arguably, under the form of renewal for a further term of office - of directors having the qualities required to run a company, but “remuneration is one of the key areas where executive directors may have a conflict of interests and where due account should be taken of the interests of shareholders”. Read in the light of the Preamble, all the provisions above listed demonstrate that the Commission - in inviting Member States to set up appropriate governance controls on the directors' remuneration according to their own corporate governance systems (Preamble, Recital 2), for protecting shareholders' interests - assumed *shareholders to consider in their own interest not the payment to directors of the lowest possible remuneration as a way to reduce the costs and maximise their dividends* in any financial year, but the *payment of a remuneration at such a level and with such a timing, linked to company's performance*, as to be compatible with the maintaining of the company's sound economic and financial conditions. This makes it appropriate the link between the (economic and financial) performance of the company and the remuneration of these directors: in effect, the costs relating to directors remuneration falls within the category of costs relating to the company's ordinary business activity. In other words, the 2004 Recommendation may be read as aimed at safeguarding the company's sound economic and financial conditions – which may be compromised, inter alia, by the payment to directors of excessive remunerations, unrelated to objective parameters – and, as a result, the shareholders' (short term as well as long term) interests *to maintain these conditions*. Moreover this Recommendation, by mentioning in its Preamble the *retention* of directors and by containing provisions on shares-based remuneration, also seems to implicitly recognise that, *the shorter the term of office* of these directors, *the higher the risk that these directors*, in particular if not remunerated by means of share packages, will neither identify their interests with those of shareholders nor place them in a long-term perspective when assessing their own interests and acting accordingly. With regard to non executive directors, the 2005 Recommendation invites Member States to introduce, at national level, a set of provisions concerning the role of non-executive or supervisory directors and the committees of the supervisory board to be used by listed companies, and provided guidelines in this respect: in its Preamble (Recital 17), the Commission, after highlighting that the presence of independent representatives on the board (to control executive directors' activity) is widely considered as a means of protecting the *interests of shareholders and other stakeholders*, and taking note of the different concerns that typically characterise companies with disperse ownerships and companies with controlling shareholders, clearly stated that “Ensuring adequate protection for third parties is relevant in both cases”. The aim is,

therefore, that of ensuring this protection, inter alia, in the decision-making within the company, in which it regarded the role of non-executive or supervisory directors and of the committees of the supervisory board as crucial for this purpose. Considered together, the two Recommendations may thus be taken as an indication that, in the Commissions' assessment, on the one hand any potential "harm" to the sound economic and financial conditions of the company (particularly for listed companies) – such as uncontrolled executive directors' remuneration and discretion – are to be avoided, and, on the other hand, appropriate mechanisms to reduce or avoid these risks are to be implemented, in the protection of shareholders' interests to maintain these conditions which are also assumed to protect third parties. This is in line with the indications which, as showed above, can be drawn from EC hard law.

The arguments that can be deduced from EC law do not contrast with definitions of corporate governance put forward by the management-oriented literature, but complement them. If corporate governance is regarded as "the structure that is intended to make sure that the right questions get asked and that checks and balances are in place to make sure that the answers reflect what is best for the creation of long – term, sustainable value" (R.A.G. Monks and N.Mirrow, Corporate governance, Blackwell Publishing, 2003, p. 2), the indications offered by EC law serve to specify that the right question to be asked is *how to allow the business activity to develop under sound economic and financial conditions*; and that any system of check and balances, which may differ from one company to another to suit the individual situations, is justified and can be maintained *to the extent that it provides the right answer to that question for the company under consideration*. As implied by the identification of the sound economic and financial conditions, the right answer is the one which allows the business activity to produce "profit of quality" to the satisfaction of both shareholders and stakeholder. Indeed, from the management and finance literature also shows that the "long-term value" finds a precondition exactly in the sound economic and financial condition, and particular in the related necessity of deriving profit from the ordinary activity: in fact, the methods of valuation of firms' value tend to determine the value of the firm's activity by capitalising a profit or cash flow *obtained from the ordinary activity* (profit or cash flow from which extra-ordinary components are eliminated before the calculation: see L.Guatri, Valuation of firms).

This management literature has also highlighted that shareholders and stakeholders' interests are compatible in the long-run (R.A.G. Monks and N.Mirrow, p. 533): the arguments that can be deduced from EC law about the vision of corporate governance underpinning the Treaty and the acquis communautaire above indicated, in addition to assuming this compatibility, suggest a specific criteria – the obtaining of profit of quality, reflected in sound economic and financial conditions – which is supposed to make shareholders and stakeholders interest compatible in the short run too, and which thus is supposed to be able to guide the directors of the company, and the mechanisms of checks and balances, in reconciling these interests in any short term choice. It may be added that *these arguments also indicate when a company may be regarded as successful*, by indicating that it may be regarded as such when obtaining over time profit of quality, *and that they offer all constituencies a measurable yardstick to assess their own interest*, that is to assess whether or not short-term choices by directors, that they may be tempted to oppose at first, actually benefit their own

(longer –term and) paramount interest to obtain continuous (over-time) benefit from their stake in the company. In fact, this criteria enables each constituency to go beyond the immediate perception (which may suggest conflicts with the interests of others) in the assessment of its own interest, and to use a measurable longer term criteria (which may indicate coincidence of interests) in this assessment. The criteria can thus allow each constituency to regard its interest, also in the short term, as compatible with that of others, that is as satisfied by directors' choices that, by helping the sound economic and financial conditions of the company, allow both itself and other constituencies to get continuous benefits from the company. In turn, this assessment by shareholders and other stakeholders should allow directors and managers to design and to implement a series of short-term choices which are not regarded as damaging a specific constituency and which result in the long-term success of the company (which long-term success is the consequence of a series of choices made in the shorter term, whose results are to be verified by means of the “truest and fairest” view of the economic and financial conditions; this truest and fairest view also serves to assess what may be, in the common interest, the necessary operational choices for achieving the long-run success in terms of value creation).

In essence, it may thus be concluded that the indications to be drawn from the *acquis communautaire* would “fit in” with any other definition of corporate governance and that, as regards the most widely accepted definition of corporate governance, this finds legal grounds in EC law, *provided that the reference to the sound economic and financial conditions is added to that definition*. This addition is necessary because the sound economic and financial conditions are, arguably, the key element which summarises and implies the competitiveness of the company with the satisfaction of both shareholders and stakeholders (allowing the making of “profit of quality”).

B. The likely criticism and possible responses..

It follows, from the above analysis, that there are indications that EC law, in addition to a definition of the corporate objective, implies a definition of corporate governance as “the system by which companies are directed and controlled, through a set of relationships between the management, the board, the controlling shareholders and other stakeholders, *in such a way as to pursue the ultimate objective of development of the business activity under sound economic and financial conditions*”. Moreover, from the various indications that suggest that the pieces of EC legislation (and soft-law) appear to suppose or to be aimed at fostering long-term relationships with the constituencies (*supra*, par. A., point B and D), it follows that the most appropriate concept of “stakeholders”, and the one assumed in this definition, would need to identify as “stakeholders” those who ensure a continuous contribution (such as, e.g., a stable customers' base), over time, to the life of the company, and thus allow it to maintain sound economic and financial conditions.

Because a reference to “financially viable enterprises” or to “corporate performance” is already contained in numerous documents amongst the existing ones on corporate governance (OECD Principles, ICGN), which do not bring this reference into the definition of corporate governance, it may be noted that the refined definition proposed here only represent a *slight* focus reorientation. However, this reorientation turns up being significant: rather than taking from

granted the objective and focusing on the interests of the parties involved, this definition identifies the corporate objective implied by EC law, which is supposed by the “*acquis communautaire*” to satisfy all interests, and it requires an in-depth analyses of all elements characterising corporate governance – such as directors’ duties, accountability of directors, shareholders’ value, the role of stakeholders, the corporate governance structure – in relation to this objective.

Admittedly, some strong objections could be raised to this slight re-definition, that is to the re-reading of corporate governance elements and definition based on the Treaty, on secondary legislation and on the ECJ case-law.

First, it may be objected that, because the Treaty and the secondary legislation above indicated (the Fourth Directive, the Regulation on accounting principles, the new Directive on statutory audit etc..) make no mention of corporate governance, the EC provisions under consideration only need to be read in view of their expressly stated purpose, and of the rules they laid down. In other words, the criticism may be addressed to the attempt in itself to extrapolate a definition of corporate governance from EC law outside the APCLCG. With regard, in particular, to the Treaty, this type of criticism may also be based on the fact that 50 years ago, when the Treaty of Rome was first drafted, corporate governance was not yet at the top of the reform agenda all over the world (there not had been the corporate collapses that some decades later, at the end of the XX and at the start of the XXI century, were bound to bring the attention on corporate governance), so that it may point out that they could not have written any provision in view of corporate governance. Nevertheless, this criticism would fail to consider the circumstance – referred to above (see A) - that in 1957, when the Treaty was drafted and agreed, all six founding States required company’s registered office and company’s head offices (principal place of activity) to be located in the same jurisdiction, by adopting a criteria (the “*real seat*” criteria) which historically found its justification in the necessity of effectively protecting all parties dealing with the company, and that the protection of third parties interests is highlighted by the ECJ case-law. It follows that one of the aspects of corporate governance, the role of and the protection of the interests of stakeholders, could certainly not be ignored by the Treaty’s drafters, being it an underlying concern in all national company laws. This realisation strengthens the refined definition of corporate governance that can be extrapolated from the Treaty and from the secondary EC legislation above indicated, which definition indicates *when stakeholders’ interests are supposed to be protected*. Moreover, even if accepting the historical argument of this possible criticism as regards the Treaty, the criticism would confuse *what* may have been the historical reality with *what* would currently be required in terms of company’s conduct, in a dynamic economic and commercial environment deeply different from that which existed when the Treaty was first drafted, in order for the goals set in the Treaty to be best achieved and in order for its provisions to find the appropriate economic background & environment. Put differently, the criticism would fail to place “the law in context”: the circumstance that the Treaty may have been written without considering corporate governance does not make useless an attempt, in an economic and commercial environment deeply different from that existing at the time of the Treaty’s drafting (and where corporate governance has become of key importance), to extrapolate from its unchanged provisions a concept of corporate governance. On the contrary, it makes this attempt even more necessary: this is because, as it has been written regarding another area (corporate taxation) which,

just like corporate governance, may not have been considered at the time of the Treaty's drafting, the changed economic and commercial environment and the Lisbon-objective "forces us to rethink the fundamental values and hard law of the EC Treaty and its secondary legislation" [W.Schon, Tax competition in Europe].

Second, it could be objected that this slight re-definition of corporate governance relies on a definition of stakeholders as those who offer a stable contribution to the life of the company, that is on a definition which seems to reflect the 1963 definition [Freeman, Strategic Management: A stakeholders approach] of stakeholders as those without whose support the business activity cannot survive. The objection might thus be that it is obsolete to the extent that it neglects the later, and currently most accepted, 1984 definition of stakeholders [Ed. Freeman, Stakeholder theory], as those who impact on the company's activity or upon whom the company's activity can have an impact. Nevertheless, this criticism would fail to consider that the description of stakeholders as those who contribute in a durable manner to the life of the company actually manages to reconcile the two definitions of stakeholders and uses both of them: whilst those without whose support the company cannot survive may be regarded as the *current stakeholders*, those upon whom the company's activity has an effect, and who would like this effect not to be negative, may be considered as the *potential stakeholders* and the most effective way for the company to make continuous and sustainable "profit of quality", thus to achieve and maintain sound economic and financial conditions, is to turn an increasing quantity of potential stakeholders into current stakeholders (e.g., by acquiring an increasing number of satisfied and, thus, stable customers and employees) upon whom to rely in mutually beneficial long-term relationships. Moreover, the 2005 Commission Recommendation on the role of non executive or supervisory directors indirectly appears to offer another argument in favour of the definition of stakeholders indicated, here, as the one emerging from EC law. In the Preamble to this Recommendation, after stating that ensuring adequate protection for third parties is relevant in both companies with a dispersed ownerships and companies with controlling shareholders, the Commission stressed that the management function should be subject to an effective independent supervision, where independence "should be understood as the absence of any material conflict of interest; in this context, proper attention should be paid namely to any threats which might arise from the fact that a representative on the board has close ties with a competitor of the company". Indirectly, the Commission expressed thus the view that a category of economic agents on which the activity of the company has an impact, that is competitors - which cannot (in normal circumstances) have a positive expectations on the effects of the company activity on them - cannot be regarded as stakeholders, which strengthens the definition of actual or potential stakeholders above proposed (where the potential stakeholders are those upon whom the activity of the company has an impact that they would like to be not a negative and, more specifically, a positive one). The realisation that, for the Commission, competitors cannot be regarded as stakeholders is strengthened by a provision of the 2004 Recommendation on the appropriate regime for the remuneration of directors of listed companies, according to which the disclosure of information in the statement of remuneration policy should not entail the disclosure of information of a commercially sensitive nature (whose disclosure would risk damaging the company' activity to the benefit of competitors). With this concept of stakeholders, it also becomes understandable that real "conflict of interests" – in

the short as well as in the long run – can only exist with (non shareholders) and non stakeholders (such as with competitors or parties related to them), that is with those who would not benefit from the company's survival and development under sound economic and financial conditions, or in any case with those who would be in a position where they may be induced to disregard, in order to get what they believe to be the maximum benefit for themselves, the company's survival and development under sound economic and financial conditions. This latter case - as previously indicated, and as the Commission apparently understood in the 2004 Recommendation - may well be the case of executive directors which are not shareholders, and it risks being so to a higher extent the shorter the duration of their term of office. On the other hand, under the conception of "stakeholders" above described, any individual or group with a short term or "una tantum" relationship with the company could not be properly included in the "stakeholders" category, but could better be referred to, e.g., as "occasional counterpart".

The concept of stakeholders as those upon whom companies can rely on a mutually beneficial long term relationship implies that, in the relationships of constituencies (stakeholder groups, i.e. shareholders and other stakeholders) with each others, there may only be *short term perceptions of conflicting interests*, interests which, however, cannot be truly regarded as conflicting to the extent that all of them wish and can gain, over-time, continuing benefit from the company's activity. What is needed to ensure this continuing benefit (the sound economic and financial conditions) therefore becomes the objective yardstick that each constituency can use to assess its own satisfaction.

Thirdly, a further objection may be based on an enforcement problem. Specifically, it might be argued that, because this definition can be seen as implied by EC law but it is not expressly put forward in either a Regulation or a Directive, in the event that in a Member State a stakeholder or a stakeholders group – e.g., creditors, employees - realise that directors are not acting in a manner consistent with the sound economic and financial conditions they could not held directors accountable. E.g., directors may believe that the interest of the company coincide with the interests of shareholders who appointed them; these directors may thus approve – and managers may engage in - operations which they perceive as greatly profitable for those shareholders, without paying attention to possible risks of compromising, in the longer run, the sound economic and financial conditions. At a first sight, the question how could stakeholders held directors to account in the event of the sound economic and financial conditions being compromised by risky operations undertaken by directors in pursued what they may perceive as shareholders' interests might be seen as unanswerable (and thus the definition of corporate governance proposed here might be criticised as useless): this would be the case if one adopted the classic view that corporations are the property of shareholders, that stakeholders have no legitimate authority over it and that only shareholders can held directors accountable (E. Sternberg, *Corporate Governance: Accountability in the Marketplace*, 2004). This criticism would however be unfounded, to the extent that it would neglect that those interested in the proper implementation by the State of the relevant pieces of EC law (that is, of the pieces of EC law which, interpreted in the light of the Treaty's goals, suggest that the refined definition of corporate governance could be extrapolated) may challenge, on ground of improper implementation, any national legislation that, by defeating the scope of the EC legislation at stake, would allow directors and managers to act

in the above exemplified way. The Fourth Directive on the true and fair view has already proved enforceable before the ECJ, and the provisions of the Directives on “financial transparency” (2006/46/EC) and of the Directive on “statutory audit” (2006/43/EC) – which latter Directive requires risk management systems – are apparently formulated in a sufficiently clear and precise manner, that is they are bound to have direct effect if not properly and/or timely implemented (according to a well-settled ECJ case-law: e.g., Case C-6/90, Francovich, 1991 ECR I-5357). In addition, minority shareholders whose position are more similar to that of stakeholders than to that of decision-makers shareholders may have recourse to remedies offered by national laws to qualified minorities, which entitle them to check the operation of directors, and to internal audit committees.

Forty, it may also be objected that, if the degree of fulfilment of directors’ duties were to be assessed in terms of achievement and maintaining of sound economic and financial conditions, that is if directors were to be accountable for that purpose, there would be the risk of too many legal actions brought against the directors any time the economic and financial conditions of the company get worse from one financial year to another. It might thus be objected, first, that a definition of the corporate objective in terms of competitiveness of the business’ activity over time, as reflected in the sound economic and financial conditions, would risk generating high costs for legal actions on behalf of the company, and, secondly, that these costs would negatively affect (if not timely recovered) the economic and financial conditions themselves and these legal actions against directors would prevent them from working in an efficient and effective manner. Nevertheless, this possible criticism would fail to consider that, ultimately, an assessment of directors’ performance on the basis of an objective parameter relating to the success of the business activity would also result from the positions submitting that the “objective function of the firm is to maximise total long-term firm market value” (Jensen, 2001), that directors’ tasks are to set systems of minimising the risks on the company’s business activity (Dine, 2001), and that, in situations which are in the vicinity of company’s insolvency, directors could follow an “entity maximisation approach” (Keay, 2005). Thus, an assessment of directors’ performance on the basis of sound economic and financial conditions would not be qualitatively different from an assessment on the basis, e.g., of value maximisation, or risk management, or entity maximisation: by contrast, it could be reasonably argued that the achievement of sound economic and financial conditions, with “profit of quality” (i.e., profit from the ordinary activity, under conditions where all constituency consider their own interests as protected), and their sustainability over time is a *signal* that the firm is maximising the long-term market value or the wealth of the entity and that the risks inherent in the company business activity are being minimised. Therefore, the possible criticism above highlighted is spurious, because it implicitly assumes at, at any signal that the conditions (economic and financial) are getting worse, and that the profit of quality (from the ordinary activity) decreases, directors would be accountable (liable) and, in so doing, it fails to consider *the need to establish appropriate periods of time* (lengthy of time), in the light of micro (example: nature of business) and macro-circumstances (example: country of operation, markets of reference, client’s tastes and tendencies), with reference to which the sound economic and financial conditions need to be verified. Moreover, the possible criticism under consideration, by arguing that there would be too many legal actions, would *a priori* renounce or refuse any attempts at identifying a set of

parameters, capable of indicating the degree of satisfaction of stakeholders, and those determinants (causes) of that satisfaction which can be related to directors' working that would need to be used as a "scorecard" to identify the proper cases when a decline of conditions (economic & financial) can be attributed to directors (and when they can thus be held accountable), and to distinguish these cases from those in which this decline cannot be attributed to directors and in which it can be established that bringing actions against them would be purposeless.

Lastly, it may also be objected that, although a business remaining a "going concern" due to sound economic and financial conditions would ultimately generate long-term benefits for all parties concerned (the shareholders would continue to get dividends over time; the customers would be able to continue to rely over time on products and services that they like, the employees would be able to rely on long-term job security etc.), which would thus have the same ultimate interest, inevitably there will be someone that will only follow a short-term opportunistic approach, that is some groups that will only pay attention to their immediate economic returns. These groups – the objection may be – will not attach importance to the sound economic and financial conditions, will consider their own interest to get the highest immediate benefits as competing with the interests of others, will not agree to directors' choices inspired by the sound economic and financial conditions to the extent that these choices, in their perception, will not maximise their own immediate returns, and will thus, in this case, withdraw their contribution to the company. Shortly, the objection may be that - contrary to what was previously argued about the ability of the guiding criteria given by the sound economic and financial conditions of making the interests of all constituencies compatible in the long run as well as in the short term (supra) – any group which will not be interested in a long term relationship with the company will assess its own interest only as a maximisation of returns under a short term perspective, at the expense of the economic and financial health of the company, and would stop offering its contribution to the company if unsatisfied.

In response, it may be submitted that the position of directors making their choices in the light of the criteria given by the sound economic and financial conditions would not be different from that of directors acting as a "neutral mediators" in following an "entity maximisation approach" (Keay, 2005), because in this case, as well as in that case, directors would follow a specific criteria, i.e. an objective yardstick, guiding their choices. "To borrow" the conceptual framework of entity maximisation [and, thus, to refer to "contrasting interests that may arise at some points in the allocation of company resources" in place of "short term perceptions of conflicting interests"], it can be said that the aim of the exercise of "balancing interests" to be undertaken by directors would be the achievement/maintaining of sound economic and financial conditions, and that, if individual and groups not interested in the survival over time of the company (which the sound economic and financial conditions are able to ensure) withdraw their contribution, the ultimate effect would be that the exercise of "balancing interest" to be undertaken by directors would become easier. In other words, because a company, to have the best chances to remain a going concern, would need constituencies to take a long-term view and to consider their interests as protected not when getting the highest immediate return but when getting a continuous (positive) return over time (even if this perspective may imply accepting that, in a given period, this return may be lower than it would otherwise

be), the individuals/ groups identifying their interests only in the highest immediate returns would not be the quality of shareholders and other stakeholders that the business activity would need, in order to remain a going concern (and, as above indicated, in the conceptual framework here indicated these groups would better be qualified as “occasional counterparts” of the company) . As a result, (using the entity maximisation terminology) it may be argued that the withdrawal of contribution of these shareholders/stakeholders would not negatively affect the company itself and its other shareholders and stakeholders. It may be considered, in addition, that a long-term view leading to an assessment, by each constituency, of its own interests as coinciding with those of other constituencies, and thus resulting in an agreement on the objective to be pursued, is certainly – unlike a short term opportunistic view – consistent with the stated Community’s goals in terms of sustainable and balanced growth and social cohesion.

A last foreseeable objection may be that a company might manage to extract over time profit from its ordinary activity even where its customers base change continuously or where it has a high turnover amongst its employees or directors (in other words, even where the company deals with several “occasional counterparts”, one after another). Nevertheless, the response is implicit in the above arguments: it would need to be that the profit obtained under these conditions would not be able to reduce effectively the financial and operational risk on the company’s businesses [which risk reduction is regarded as necessary by Directive 43/2006/EC], and would thus not be classifiable as “profit of quality”, based on the satisfaction of all constituencies and thus ensuring over time, thanks to their durable contribution, the sound economic and financial conditions.

C. Conclusive remarks

Conclusively, two remarks seem to be appropriate.

First, the vision about the corporate objective as consisting in the competitiveness of the business activity reflected in sound economic and financial conditions which are regarded as being in the interest of all constituencies, and the related vision of corporate governance as allowing any structure of checks and balances that, in individual companies, may lead to that objective (which vision can be found in the Treaty and in the rest of the *acquis communautaire* interpreted in the light of it), call into question the widespread approach of studying the subject. The approach has generally assumed the perspective of which interests are to be pursued and towards whom directors are to be accountable. Indeed, this vision – which would “fit in” both in jurisdictions characterised by the separation between ownerships and control of companies and in jurisdictions characterised by the lack of this separation - suggest that, *once identified a result that is in the common interest*, directors’ duties need to be analysed from the viewpoint of that result and the accountability of directors would need to be regarded as *accountability for a result*, which accountability may be better enforced by someone (the shareholders), rather than *accountability only towards someone* (the shareholders). In other words, this vision would “give the right” to those positions, expressed in the literature, that seem to reject the classic shareholders vs. stakeholders alternative (Jensen, 2001; Dine, 2001; Keay, 2005) and to advocate a new approach of conceiving directors’ duties, that is an approach based on an objective yardstick (firm value maximisation, minimisation of risks, entity

maximisation). It would also add a clear indication about *the way in which each constituency would need to assess its own interests*, and would suggest, in the light of the sound economic and financial conditions parameter, that what (if referred to in other words, i.e. in words different from “survival and development over time of the company under sound economic and financial conditions”) can be regarded as “maximisation of (shareholders or firms) value” over time can better *result from the achievement of a qualitatively different corporate objective* than be pursued as an objective on its own.

Second, the responses to the possible objections indicate that, if the re-reading about the corporate objective and about corporate governance emerging from the Treaty (and the *acquis communautaire* above considered) is accepted, there are certainly ways forward for research. One issue would be the necessity of identifying a set of non economic and non financial parameters which could indicate, within an appropriate length of time, the degree of satisfaction of all current stakeholders and the company’s ability of turning the potential stakeholders into current stakeholders. In other words, to identify a series of non economic and non financial parameters would which could be seen as indicating a pre-condition for the achieving and the maintaining of profit of quality (sound economic and financial conditions), and which could also serve to find out which causes of the sound economic and financial conditions, in the short run and in the longer term, can be seen as more directly connected with directors’ choices. This would also provide a criteria to measure when the risks inherent in the business activity are successfully managed (i.e., are minimised), and when the risk control system is successfully operating (control system required by the EC Council Directive on statutory audit). In addition, the measurement would also make it possible to assess when/if the firm is maximising long term net market value and, if not, to identify the causes of the failure of doing so. This would provide a framework for developing an approach of directors’ accountability for a result.

On the other hand, if accepting that, in order to achieve and to maintain sound economic and financial conditions (and to improve these conditions from one year to another), any company needs to turn in increasing number of potential stakeholders into happy current stakeholders, nationally as well as internationally, the parameters to be identified in the search above referred to can become a “score” through which to measure the company’s performance in terms of CSR and advancement of human rights commonly associated with CSR, which performance would also, in turn, help company’s competitiveness [see *inter alia*, the acknowledgment, by the UK Government and by the Commission in its Communications on CSR, that CSR makes companies more competitive; in this regard, also the evidence cited by the European Bahai Business Forum] and would indicate a type of business conduct consistent with EC law (which also recognises human rights, ex Art. 6 European Union Treaty). This “score”, if applied to measure the performance of companies characterised by different corporate governance structures and if revealing a better performance by some of these companies, could pave the way to the search for an optimal corporate governance structure & mechanisms of interactions between the protagonists - and in primis between directors, shareholders and stakeholders - capable of ensuring both CSR and the advancement of human rights from business conduct, as a cause and as an effect of the achievement of “profit of quality” and of sound economic and financial conditions. Ultimately, there would be scope for the elaboration of a

workable concept of “quality” for corporate governance, that is, for such a concept compatible with EC and international legal order.

Thus, it may be conclusively argued that, rather than an “end of the history” for corporate law and for corporate governance debates resulting in a “victory” of the shareholders model (H. Hansmann & R. Kraakman, “The end of history for corporate law”, in “Convergence and persistence in corporate governance”, ed. by J.N.Gordon and M.J.Roe, 2004, pp. 33-68), a re-reading of EC hard law from a “corporate governance perspective” (and of the views expressed by the Commission in its soft-law pieces) - in the light of the lesson from the recent and notorious corporate collapses (where the activity of the involved businesses was nearly destroyed), and in the wait of the outcomes of the complete implementation of the APCLCG - suggests a slight re-definition of corporate governance. This slight re-definition, by being based on a corporate objective to be identified in clear terms regarding business’s survival and success, indicates once again that a new start in corporate governance debates and research - already advocated by that part of the literature claiming e.g. the reduction of the risks on the company’s business activity, or the maximisation of the firm’s wealth or market value, as the priority for directors – definitively deserves to gain momentum and can find key issues as a way forward.